

Office of the City Auditor

**Report to the City Council
City of San José**

**TEAM SAN JOSE'S
PERFORMANCE 2014-15**

**Report 15-11
November 2015**

November 6, 2015

Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

Team San Jose's Performance 2014-15



San José McEnery Convention Center; photo by City Auditor's Office

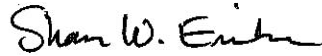
Since 2004, the San José McEnery Convention Center and several other City-owned facilities have been operated on the City's behalf by Team San Jose, Inc. The Management Agreement between the City and Team San Jose requires an annual audit by the City Auditor of Team San Jose's management of the Facilities. Our objective is to determine whether, and how well, Team San Jose achieved its agreed-upon performance goals and incentive fee targets that are the basis for the City's incentive payment to Team San Jose.

Team San Jose Achieved a Weighted Incentive Fee Score of 131 Percent. In FY 2014-15, Team San Jose drew 1.4 million people to events at the Convention and Cultural Facilities and booked 213,000 future hotel room nights. It surpassed its fiscal performance targets. It met all economic impact targets. It achieved its customer service goal and two theater goals. Altogether, Team San Jose achieved a weighted incentive fee score of 131 percent and thus qualifies for the incentive fee of \$200,000.

Roles for Managing the Theater Preservation Fee Need Clarification. Since 2007, theater patrons have paid a \$1 fee per ticket to a non-profit organization, intended to fund facility improvements at the City-owned theater buildings, but the City's and Team San Jose's roles in managing this fee and managing facility improvements are unclear. We recommend the City Manager's Office work with the parties involved to clarify the roles.

We will present this report at the November 16, 2015 meeting of the City Council's Community and Economic Development Committee. We thank Team San Jose and the City Manager's Office for their time and cooperation during the audit process. The Administration's response is shown on the yellow pages.

Respectfully submitted,



Sharon W. Erickson
City Auditor

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This report is also available online at www.sanjoseca.gov/audits

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Introduction

The mission of the City Auditor's Office is to independently assess and report on City operations and services. The audit function is an essential element of San José's public accountability and our audit reports provide the City Council, City management, and the general public with independent and objective information regarding the economy, efficiency, and effectiveness of City operations and services.

In accordance with the City Auditor's fiscal year (FY) 2015-16 Audit Work Plan, we have completed an audit of Team San Jose, Inc.'s (TSJ) management of the City's Convention and Cultural Facilities. Our audit purpose was to determine whether Team San Jose met the performance measures specified in the *Agreement for the Management of the San José Convention Center and Cultural Facilities Between the City of San José and Team San Jose* (Management Agreement) for FY 2014-15.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the "Audit Objective, Scope, and Methodology" section of this audit report.

We thank Team San Jose and the City Manager's Office for their time, information, insight, and cooperation during the audit process.

Background

The San José Convention and Cultural Facilities (the Facilities) are City-owned and consist of:

- The San José McEnery Convention Center
- South Hall
- Parkside Hall
- The City National Civic (formerly known as Civic Auditorium)
- The Center for the Performing Arts
- The California Theatre
- The Montgomery Theater

The Convention Center, South Hall, and Parkside Hall offer trade shows, conventions, corporate meetings, social events, and consumer shows.

The Cultural Facilities host performing arts, concerts, and events. These include, but are not limited to, performances by the Symphony Silicon Valley and Opera San Jose (at the California Theatre), the Children's Musical Theater of San Jose (at the Montgomery Theater), and Ballet San Jose and Broadway San Jose (at the Center for the Performing Arts/California Theatre). The City National Civic is pictured in Exhibit I.

Exhibit I: City National Civic



Photo by City Auditor's Office

Team San Jose, Inc., a non-profit corporation, was formed in 2003 in response to the City's request for proposal (RFP) for the management and operations of the Convention Center, which had previously been managed by City staff in the former Department of Convention, Arts, and Entertainment. Team San Jose has a 15-member board of directors that includes representatives from local hotels, arts, business, and labor. It also includes a City Council liaison and an ex-officio member from the City Manager's Office. The City's Management Agreement with Team San Jose requires the City Auditor's Office to conduct an annual audit of the performance measures in the agreement.

Team San Jose Has Managed the Facilities Since 2004

For a history of the Facilities' operations and information regarding the 2004-2009 and the 2009-2014 contracts, see our previous audits, available online at www.sanjoseca.gov/audits.

In June 2014, the City and Team San Jose entered into a new Management Agreement for the period of July 1, 2014 through June 30, 2019, with two additional five-year options. Comparing this Management Agreement to the prior one, Team San Jose gained the ability to modify its adopted budget, the theater

performance measures changed, the management fee and incentive fee amounts changed, and Team San Jose took charge of standard capital improvements and repairs.

The 2014-2019 Management Agreement provides that the City pays Team San Jose a \$1 million management fee per year. If certain performance targets are met, the City also pays Team San Jose a \$200,000 incentive fee.

The City and Team San Jose also have a separate contract under which Team San Jose provides convention and visitors bureau (CVB) services on behalf of the City.

The City Accounts for the Facilities in a Separate Fund

The City budgets for the Facilities' operations and capital improvements in the *Convention and Cultural Affairs Fund* (Fund 536). This fund receives a portion of the City's hotel tax revenues. The City Council approves the annual budget. Beginning with FY 2014-15, this fund no longer shows the detailed revenues and expenses of Team San Jose, but instead only the operating subsidy.

Audit Objective, Scope, and Methodology

The objective of our audit was to determine whether Team San Jose met its performance and incentive fee measures for FY 2014-15. To do so we:

- Reviewed relevant documents including: the Management Agreement, Council-adopted performance targets, TSJ's performance reports, the FY 2014-15 audited financial statement for the Facilities, the Convention Center debt service schedule, parking garage revenue and expense reports, Budget Office reports for the Convention and Cultural Affairs Fund (Fund 536), TSJ's attendance and theater records, the agreed-upon procedures for hotel-room night bookings performed by *Petrinovich Pugh & Company, LLP* on TSJ's behalf, and TSJ's customer service surveys for the year
- Interviewed management and staff from TSJ, as well as from the City Manager's Office of Economic Development and Budget Office about the performance measures and TSJ's accomplishments for the year
- Tested the accuracy and completeness of TSJ's recording of the number of performances and special events for theaters, and attendance at convention and cultural events during the year
- Tested the accuracy of TSJ's computation of gross revenue, "gross operating profit," and "return on investment" using the audited financial statements and the Management Agreement's methodologies, and TSJ's estimation of economic impact using approved economic models.

In response to stakeholder requests, we also gained a background understanding of the theater preservation fee. This \$1 per-ticket fee paid by theater patrons was intended to fund facility improvements at the Cultural Facilities.

Finding I Team San Jose Met All Its Targets in FY 2014-15

Summary

In FY 2014-15, Team San Jose drew 1.4 million people to events at the Facilities and booked 213,000 future hotel nights. The Management Agreement requires Team San Jose to report annual performance compared to targets established by the City. In addition to surpassing financial targets for gross revenue and “gross operating profit,” Team San Jose exceeded all four of its performance measures for economic impact: hotel room nights, event attendance, estimated economic impact, and “return on investment.” Team San Jose also met its performance targets for customer satisfaction and its two theater measures – performances and special events. In aggregate, Team San Jose achieved a weighted incentive fee score of 131 percent and thus qualifies for the incentive fee of \$200,000.

The Performance-Based Agreement Between the City and Team San Jose Establishes Performance and Incentive Measures

The 2014-2019 Management Agreement outlines nine measures that track Team San Jose’s financials, economic impact, theater performance, and customer survey results. Eight of those measures track “performance.” Another set of seven measures determine incentive pay – the “incentive fee measures.”¹ Exhibit 2 shows these measures and their weighting.

Exhibit 2: Performance Measures, Incentive Fee Measures, and Their Weighting

Performance Measures		Incentive Fee Measures	
“Gross Operating Profit”	40%	Gross Revenue	40%
Economic Impact	40%	Economic Impact	40%
Hotel Room Nights (10%)		Hotel Room Nights (15%)	
Attendance (10%)		Attendance (10%)	
Estimated Economic Impact (10%)		Estimated Economic Impact (15%)	
“Return on Investment” (10%)			
Theater	10%	Theater	10%
Performances (5%)		Performances (5%)	
Special Events (5%)		Special Events (5%)	
Customer Satisfaction	10%	Customer Satisfaction	10%
Total	100%	Total	100%

Source: Management Agreement between the City and Team San Jose

¹ Because construction of the facilities managed by TSJ was financed through tax-exempt debt, the management agreement cannot, according to the City Attorney’s Office, have an incentive pay provision that is based on return on investment or net profit; hence, the incentive fee measures used to determine TSJ’s incentive pay differ slightly from the general performance measures.

For FY 2014-15, the City Set Targets Near or Slightly Below Results Achieved in the Year Prior

Incentive contracts, such as the City's Management Agreement with Team San Jose, have been common in government for several decades. In 1998 *Best Practices for Performance-Based Service Contracting*,² the White House Office of Management and Budget described performance-based contracts as follows:

Performance-based service contracting... is designed to ensure that contractors are given freedom to determine how to meet the Government's performance objectives, that appropriate performance quality levels are achieved, and that payment is made only for services that meet these levels.

Concerning incentives, the best practices caution that:

Care must be taken to ensure that the incentive structure reflects both the value to the government of the various performance levels, and a meaningful incentive to the contractor. Performance incentives should be challenging yet reasonably attainable. The goal is to reward contractors for outstanding work, but not penalize them for fully satisfactorily but less than outstanding work.

We reiterate our point from the last three Team San Jose audits that the City should set challenging targets. The City's targets and the \$200,000 incentive fee, in our opinion, should encourage Team San Jose to outperform prior successes and reward continuous improvement. Targets that are merely forecasts of events already confirmed and revenues already planned will not necessarily encourage improved performance.

Team San Jose Proposes Its Targets and the City Approves Targets

Under the Management Agreement, Team San Jose annually proposes its own targets and then the City reviews and approves them.³ This structure could encourage contractors to underestimate future revenues and events. Team San Jose explained that many external factors impact its performance.

² Although the Best Practices document was subsequently rescinded, its overall message is echoed in Federal Acquisition Regulation and in the National Institute of Government Purchasing's guidance on performance-based contracting.

³ The Management Agreement requires the City to approve targets prior to the beginning of each fiscal year. The City also uses a consultant with expertise in the convention, entertainment, and visitor industries to evaluate Team San Jose's proposed targets.

From FY 2009-10 to 2012-13, the City generally lowered targets because of economic uncertainty and anticipated disruptions from the Convention Center's renovation and expansion. In hindsight, the City expected construction would begin sooner than it did and may have overestimated construction impacts (or underestimated TSJ's ability to mitigate the impacts).⁴

For FY 2014-15 again, the City set performance targets near or slightly below performance achieved in the previous year. The City Manager's Office in late 2014 echoed TSJ's expectations that revenues and the number of events would decline.⁵ In fact, as shown below, TSJ outperformed its own prior-year achievements on six measures in FY 2014-15. Revenues and event attendance did not decline.

Team San Jose Exceeded all of its Performance and Incentive Targets in FY 2014-15

Based on our review of the audited financial statements,⁶ third-party reviews of hotel room night bookings, and Team San Jose's attendance, theater, and customer satisfaction records, we found that Team San Jose:

- Met targets for all eight of the performance measures
- Met targets for all seven of the incentive fee measures

Team San Jose's performance against each target is shown in Exhibit 3, as are the calculations of the weighted performance score and the weighted incentive fee score.

⁴ **Appendix B** shows TSJ's performance for the past 10 years as well as targets for the past 10 plus the current year.

⁵ City Council meeting December 9, 2014, item 2.11: <http://sanjoseca.gov/DocumentCenter/View/37848>

⁶ The financial audit of the City's Convention and Cultural Facilities, by the independent accounting firm of *Macias, Gini, and O'Connell*, was completed in September 2015 with a clean opinion: <http://www.sanjoseca.gov/DocumentCenter/View/46698>

Exhibit 3: Team San Jose's FY 2014-15 Weighted Performance and Incentive Fee Scores

Measures	Target	Result	% of Goal	Performance		Incentive Fee	
				Weight	Score	Weight	Score
Gross Revenue and "Gross Operating Profit"							
Gross Revenue	\$25,939,000	\$37,300,000	144%	n/a	n/a	40%	57.5%
"Gross Operating Profit"	\$7,002,864	9,200,000	131%	40%	52.6%	n/a	n/a
Economic Impact							
Hotel Room Nights	200,000	213,000	106%	10%	10.6%	15%	16.0%
Event Attendance	1,035,000	1,400,000	135%	10%	13.5%	10%	13.5%
Estimated Economic Impact	\$91,120,000	\$124,100,000	136%	10%	13.6%	15%	20.4%
"Return on Investment"	2.45	2.82	115%	10%	11.5%	n/a	n/a
Theater							
Performances	86%	104%	121%	5%	6.0%	5%	6.0%
Special Events	6%	8%	133%	5%	6.7%	5%	6.7%
Customer Service							
Satisfaction Rate	95%	100%	105%	10%	10.5%	10%	10.5%
Weighted Performance/Incentive Fee Score				125.1%		130.8%	

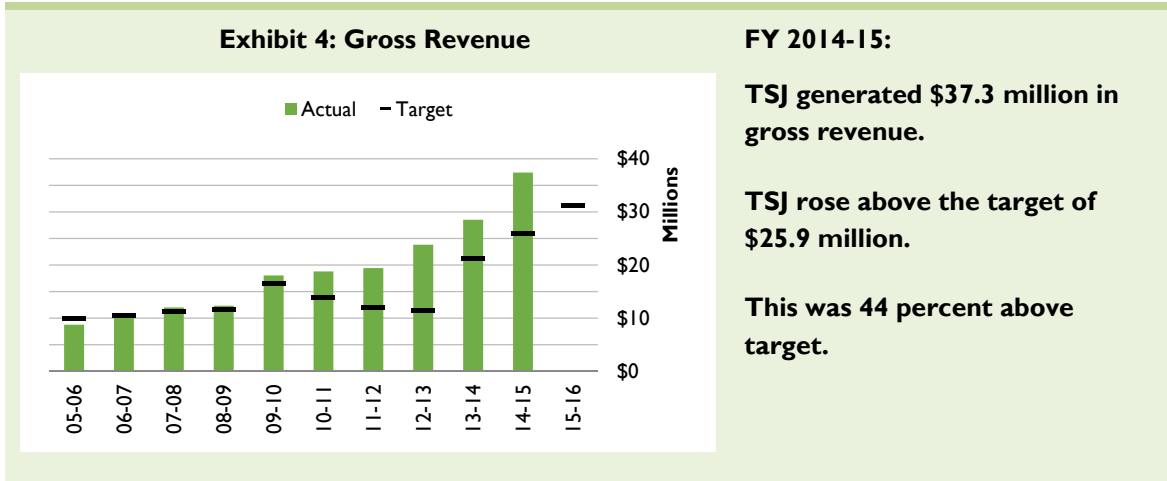
Source: Auditor analysis of the Management Agreement, FY 2014-15 audited financial statements, event attendance reports, and other Team San Jose records.

Note: weighted percentages are the product of the measure weights listed in Exhibit 2, and actual performance as a percentage of the goal. For instance, Event Attendance is given a weighted incentive fee score of 13.5 percent because the result of 1,400,000 was 135 percent of the target of 1,035,000, and the Management Agreement assigns Event Attendance a weight of 10 percent.

In the following sections, we describe each performance measure in detail and show multi-year trends. We also show the targets, including the target for the current FY 2015-16. **Appendix A** summarizes the methodology for calculating each individual measure in detail. In addition, **Appendix B** gives a one-page overview of TSJ's results and targets for performance and incentive fee measures for the past 10 years.

Team San Jose Rose Above Its Gross Revenue Target

Gross revenue, as shown in Exhibit 4, is the revenue generated from the operation of the Facilities. For example, event organizers pay TSJ rent for an exhibit hall or meeting room in the Convention Center. Gross revenues are *before* expenses. In FY 2009-10, TSJ brought food and beverage services in-house; this largely drove increases in gross revenue in every year since then.



Source: Auditor analysis of the Management Agreement, audited financial statements for the Convention and Cultural Affairs Fund, and our prior TSJ audits.

Gross revenue grew tremendously in FY 2014-15 compared to the prior year (up \$8.8 million or 31 percent), mainly because TSJ was able to sell more food and beverage services (up \$4.5 million or 33 percent) and event production services (up \$2.4 million or 36 percent). Growth in these lines of business, however, also comes with additional expenses, as shown in Exhibit 9.

Gross revenue rose 44 percent above the target. Team San Jose attributed its success in rising above the target to higher-than-expected attendance at planned events as well as unplanned events that it attracted to the Facilities. When TSJ and the City set the target, they anticipated revenues would shrink 5 percent and food and beverage revenues would fall by \$1.2 million based on the number of events that TSJ had booked.

Team San Jose Beat Its Target for “Gross Operating Profit”

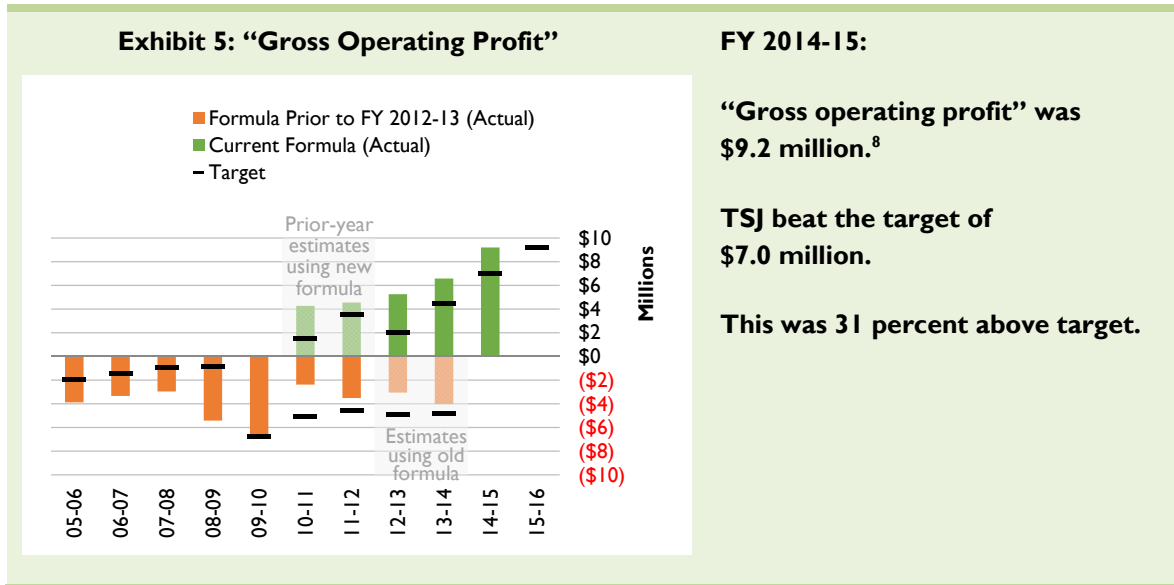
The Management Agreement defines “gross operating profit” as follows:

<p>Gross revenues from operating the Facilities (see above)</p> <p>Hotel tax revenue⁷</p> <p>Revenue from the parking garage at the Convention Center</p>	—	<p>Direct and indirect expenses for operating the Facilities (Exclude: City-directed expenses, City oversight, fire insurance, repairs and maintenance, depreciation, management fee paid by City to TSJ)</p> <p>Expenses for the parking garage at the Convention Center</p>	=	<p>“Gross Operating Profit”</p>
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⁷ Hotel taxes are formally known as Transient Occupancy Taxes (TOT). Only the portion that the City transfers to the Convention and Cultural Affairs Fund (Fund 536) counts towards “Gross Operating Profit.”

The City collects a tax of 10 percent of the rent that a hotel operator charges to a hotel guest (\$36.9 million in FY 2014-15). Four percent goes into the General Fund (\$14.7 million). Six percent goes into the Transient Occupancy Tax Fund (Fund 461, \$22.2 million). About half of the TOT Fund’s portion subsidizes the Convention and Cultural Facilities (\$9.5 million). About a quarter of the TOT Fund’s portion funds the Convention and Visitors Bureau (\$4.8 million) and about another quarter funds cultural grants (\$4.7 million).

TSJ's results for "gross operating profit" are shown in Exhibit 5.



Source: Auditor analysis of the Management Agreement, audited financial statements for the Convention and Cultural Affairs Fund, parking garage revenue and expense reports, Budget Office reports for the Convention and Cultural Affairs Fund, and prior TSJ audits.

In 2012-13, the calculation method changed. The red bars show the old formula, the green bars the new formula. The old formula was: Operating revenues – Operating expenses (excluding: depreciation, oversight, fire insurance, fixed executive management fee, repairs and maintenance).

"Gross operating profit" does **not** include the City's \$15.3 million payment in FY 2014-15 for debt service for the Convention Center's original construction, nor does it include the \$8.2 million payment for debt service for the 2011-2013 renovation and expansion.⁹

In setting the target, TSJ and the City had raised the target compared to the prior year's results, by \$400,000 or 6 percent. TSJ outperformed this modest target by attracting additional events and by maintaining a strong profit margin in its food and beverage business.

The Financial Statements Show an Operating Loss

In contrast to the "gross operating profit" results, the audited financial statements for the Convention and Cultural Facilities show an operating loss of \$8.4 million in FY 2014-15, calculated in accordance with *Generally Accepted Accounting Principles*.¹⁰

⁸ In its year-end report, before our performance audit, Team San Jose reported \$8.9 million in "gross operating profit." The difference is mainly because we are recognizing an additional \$400,000 in hotel tax revenue that Team San Jose had not counted in its calculation.

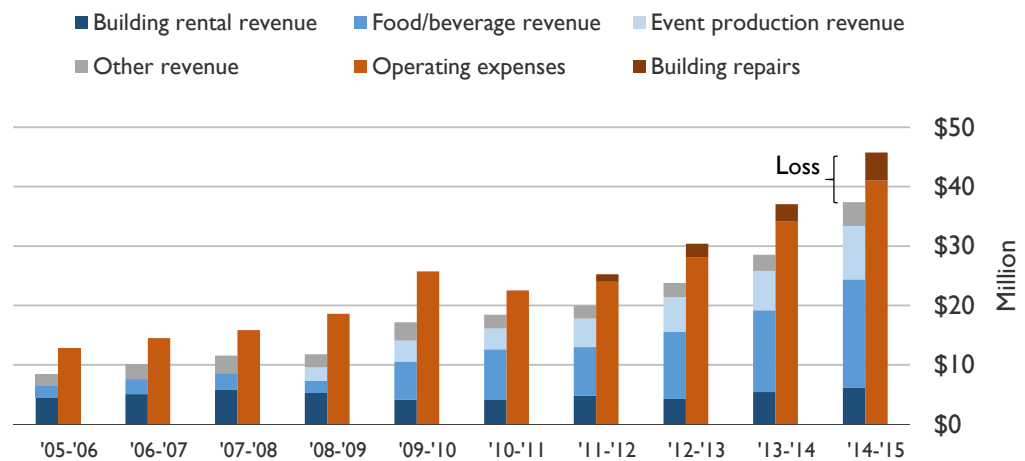
⁹ The City and Team San Jose agreed that the expansion debt would not count towards "gross operating profit" because it is paid back from a special tax on hotels that are within the Convention Center Facilities District.

¹⁰ Audited financial statements, 2014-15: <http://www.sanjoseca.gov/DocumentCenter/View/46698>

Every year in the last 10 years, the Facilities were operating at a loss, requiring an operating subsidy ranging between \$4.1 million and \$8.5 million from the City. Most of that operating subsidy has been funded by hotel taxes. Exhibit 6 shows a 10-year history of operating revenues and expenses, whose difference yields the operating profit or loss, calculated in accordance with Generally Accepted Accounting Principles.

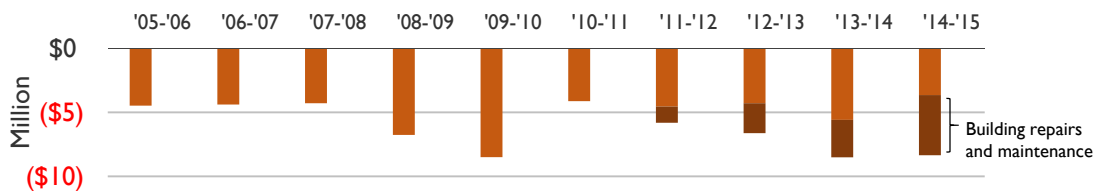
In 2014-15, the \$8.4 million loss included \$4.7 million in repairs and maintenance. In the last few years, the City and Team San Jose ramped up improvements to the buildings, enabled by strong hotel tax revenues.

Exhibit 6: Operating Revenues and Expenses in Accordance with Generally Accepted Accounting Principles



Source: Audited financial statements for the Convention and Cultural Facilities. Beginning with FY 2011-12, we show building repairs and maintenance as separate expense.

Exhibit 7: Operating Loss in Accordance with Generally Accepted Accounting Principles



Source: Audited financial statements for the Convention and Cultural Facilities. Beginning with FY 2011-12, we show building repairs and maintenance as separate expense.

The audited financial statements for the Convention Center and Cultural Facilities caution:

In order for the Center [and Facilities] to continue its operations, it relies on the City for operating contributions. The operating loss for the year was \$8,350,374, which required net operating cash contributions totaling \$7,951,328 from the City. The City uses a portion of TOT from its Transient Occupancy Tax Special Revenue Fund to fund these contributions. Accordingly, any significant changes in the TOT or a decision to change the amount of support could greatly affect the Center's ability to continue as a going concern.

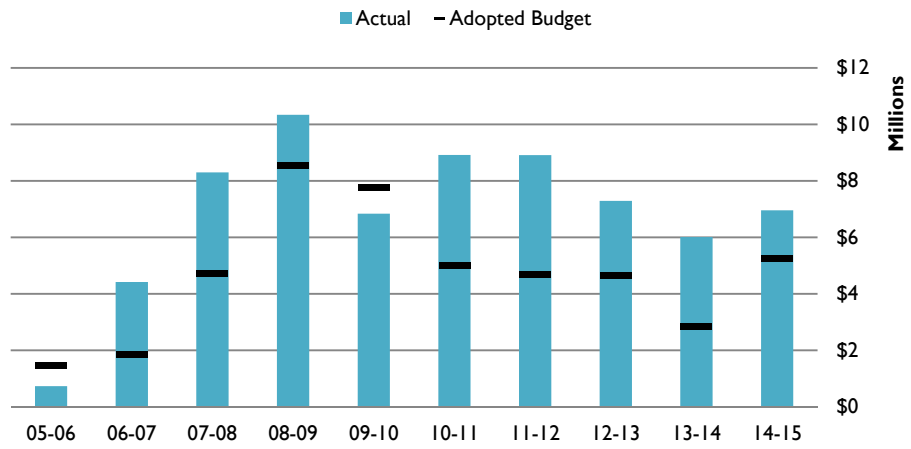
As noted in our prior reports, when TSJ performs better than expected (as it did from FY 2010-11 to FY 2014-15), it reduces the chance that subsidies from the City's General Fund would be required. Indeed, the City has not made a significant transfer from the General Fund to the Convention and Cultural Affairs Fund since FY 2009-10.

Exhibit 9 reconciles the audited financial statements to the Management Agreement's definitions of gross revenue and "gross operating profit."

The Ending Balance in the Convention and Cultural Affairs Fund Has Grown

At the end of FY 2014-15, the ending balance of the Convention and Cultural Affairs Fund was \$7.0 million, an increase of \$1.0 million compared to the prior year. Despite the losses shown above (which include some expenses for building repairs), the fund balance increased because of non-operating revenues and transfers, such as from hotel taxes. Generally, the ending balance indicates the availability of funds for future use. It includes a capital reserve of \$2.1 million, as of October 2015. Exhibit 6 shows a ten-year history of the Fund's ending balance, as adopted at the beginning of the fiscal year and actually closed at the end of the fiscal year.

Exhibit 8: Ending Balance of the Convention and Cultural Affairs Fund (Fund 536)



Source: Source and Use Statements in Adopted Budgets

Exhibit 9: Reconciliation of the Management Agreement's Measures to the Audited Financial Statements (FY 2014-15)

	FY 2013-14 Prior Year	FY 2014-15 Performance Measure per 2014-2019 Management Agreement	FY 2014-15 Audited Financial Statement in accordance with Generally Accepted Accounting Principles
Operating Revenues:			
Food and beverage services	\$ 13,767,102	\$ 18,270,531	\$ 18,270,531
Event production labor revenues	6,613,118	8,996,857	8,996,857
Building rental	5,428,565	6,123,991	6,123,991
Commission revenue	1,688,369	1,382,529	1,382,529
Networking services	0	1,148,480	1,148,480
Event electrical/utility services	461,053	486,599	486,599
Ticketing services	286,406	393,309	393,309
Audio/visual services	278,914	330,110	330,110
Telecommunications services	84,627	113,742	113,742
Equipment rentals	60,839	67,264	67,264
Other revenues	2,921	82,513	82,513
Less: City of San José credits for facility usage	(137,380) F	0	0
Total Operating Revenues	28,534,534		37,395,925
Less: Bad debt expense		(94,660) A	
Gross Revenue	28,534,534	37,301,265	
Hotel tax revenue to Convention and Cultural Affairs Fund	8,769,780 F	9,661,765 A, B	
Parking garage revenue	3,125,803 F	3,498,163 A	
Revenues for "gross operating profit" calculation	40,567,497	50,461,193	
Operating Expenses:			
Administrative and general salaries – Team San Jose	12,026,058	13,822,055	13,822,055
Cost of event production labor	6,227,291	8,491,999	8,491,999
Contracted outside services	3,282,787	4,736,115	4,736,115
Food and beverage costs	2,610,688	3,397,017	3,397,017
Repairs and maintenance – City funded	1,616,024 G	0 A	3,024,191
Utilities	2,733,494	2,823,559	2,823,559
Repairs and maintenance	1,310,042	1,685,910	1,685,910
Management and incentive fee – Team San Jose	1,080,791 G	0 A, C	1,349,996
Workers' compensation insurance premiums	909,267	1,082,259	1,082,259
Depreciation	817,166 G	0 A	1,007,500
City of San José oversight	1,085,998 G	0 A	771,348
Operating supplies	458,318	459,717	459,717
Professional services	732,839	346,717	346,717
Insurance	271,666	263,571	263,571
Fire insurance	225,504 G	0 A	236,082
Equipment rentals	146,168	231,340	231,340
City's facility use expense	0	179,569 D	179,569
Bad debt expense	20,457	0 A	94,660
Ticketing costs	71,886	51,138	51,138
Other expenses	1,419,557	1,691,556	1,691,556
Total Operating Expenses	37,046,001		45,746,299
Operating Profit or (Loss)	(8,511,467)		\$ (8,350,374)
CVB expenses paid by Convention and Cultural Affairs Fund	499,996 F	500,000 D	
Civic Auditorium temporary cooling	0	268,306 D	
City's facility use expense	137,380 F	0	
American Musical Theatre loan repayment	0	131,533 E	
Adjustments in accordance with Management Agreement	(4,825,483) G		
Expenses for "return on investment" calculation	32,857,894	40,162,361	
Parking garage expenses	1,119,298 F	1,090,333 A	
Expenses for "gross operating profit" calculation	33,977,192	41,252,694	
"Gross Operating Profit" or (Loss)	\$ 6,590,305	\$ 9,208,499	

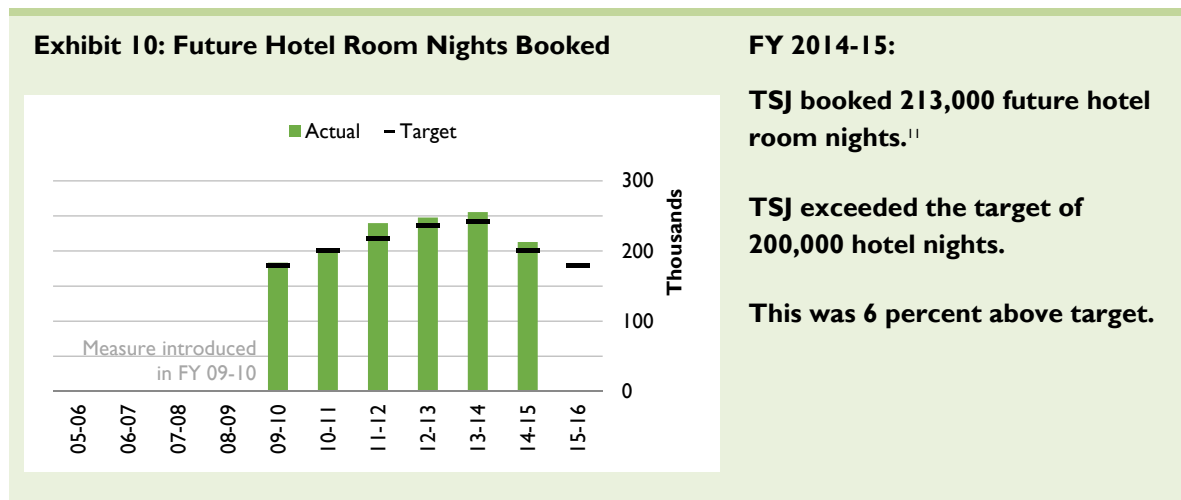
Source: Auditor analysis of audited financial statements for the San José Convention and Cultural Facilities, the Management Agreement, parking garage revenue and expense reports, and Budget Office reports for the Convention and Cultural Affairs Fund.

Notes to Exhibit 9:

- A. The 2014-2019 Management Agreement defines “gross operating profit” to include or exclude these items
- B. Consistent with prior year’s practice, for purposes of Team San Jose performance measurement hotel tax was calculated as follows: FY 2014-15 allocation of \$9,554,780 to the Convention and Cultural Affairs Fund, plus \$441,901 attributable to FY 2014-15 hotel activity but allocated to the Fund in in FY 2015-16, minus \$334,916 attributable to hotel activity in FY 2013-14 but allocated to the Fund in FY 2014-15. Any hotel tax received in a given year above (or below) the budgeted amount is reconciled and distributed to the Convention and Cultural Affairs Fund in accordance with the San José Municipal Code.
- C. The management fee shown here includes the \$1 million management fee for FY 2014-15 under the 2015-2019 Management Agreement and the \$350,000 incentive fee paid during FY 2014-15 for FY 2013-14 under the 2009-2014 Management Agreement
- D. The City’s approved target included these items
- E. Team San Jose collected a \$1 fee for every ticket sold for a Broadway San Jose show, which is included under its revenues. Team San Jose transferred those funds to the City’s Arts Stabilization Fund, to pay back a City loan of \$1 million to the American Musical Theater. \$345,000 of the loan has been repaid so far.
- F. The 2009-2014 Management Agreement and its Third Amendment defined “gross operating profit” to include or exclude these items
- G. The 2009-2014 Management Agreement and its Third Amendment defined “gross operating profit” to exclude these items which are grouped together in this table for simplicity.

Team San Jose Exceeded Its Target for Hotel Room Nights

Hotel room nights, as shown in Exhibit 10, is measured as the number of **future** hotel room nights booked by Team San Jose over the course of the fiscal year.



Source: Auditor analysis of the Management Agreement, TSJ’s hotel room nights production report, third-party reviews of TSJ’s hotel room night bookings, and our prior TSJ audits.

¹¹ 15,000 of the future hotel room nights were booked on the last three business days of FY 2014-15, pushing TSJ above the target. Confirming future hotel bookings so close to the deadline is not unusual according to TSJ.

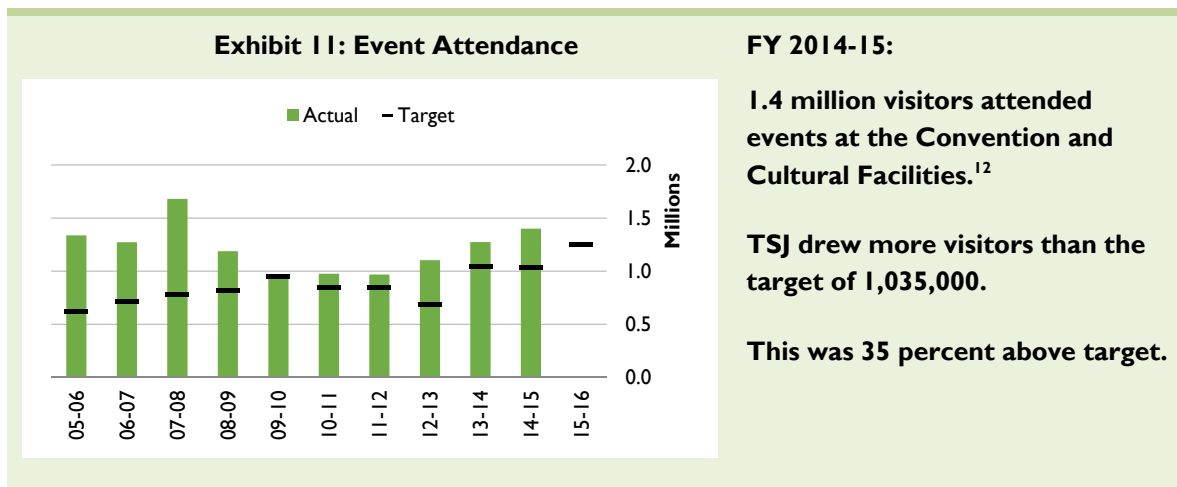
For one event, we found 900 hotel room nights at hotels in Redwood City, San Mateo, Santa Clara, and Santa Cruz. In our opinion, the City should require Team San Jose to exclude hotel room nights outside of San José from the performance measure calculation. Team San Jose explained, for this event, San José hotels had already reached capacity and booking out-of-town hotel rooms was necessary to bring the event to San José.

Team San Jose's Performance 2014-15

TSJ met its hotel night goal in each of the six years it has reported on the measure. In FY 2014-15, the hotel target and results fell compared to prior years, which the City attributed to strong corporate hotel bookings which would limit opportunities to attract large groups.

Team San Jose Surpassed Its Target for Event Attendance

Event attendance, as shown in Exhibit 11, is the number of local/social visitors, out-of-town visitors, and exhibitors who attend events at the Convention and Cultural Facilities.



Source: Auditor analysis of the Management Agreement, TSJ event attendance reports, and our prior TSJ audits.

The three largest events, in terms of visitors, were the 2015 Silicon Valley International Auto Show (360,000), WrestleMania Axxess (60,000), and “Wicked” by Broadway San Jose (57,000). These three events made up 34 percent of the total visitor count. The remaining 378 events drew between 2 and 31,000 visitors.

Although attendance was down from a peak in FY 2007-08, Team San Jose has achieved its targets for attendance in nine of the last ten years.

Team San Jose explained that it exceeded the target because of higher-than-anticipated attendance at several large events. TSJ also booked events that had not factored into the budget and target-setting.

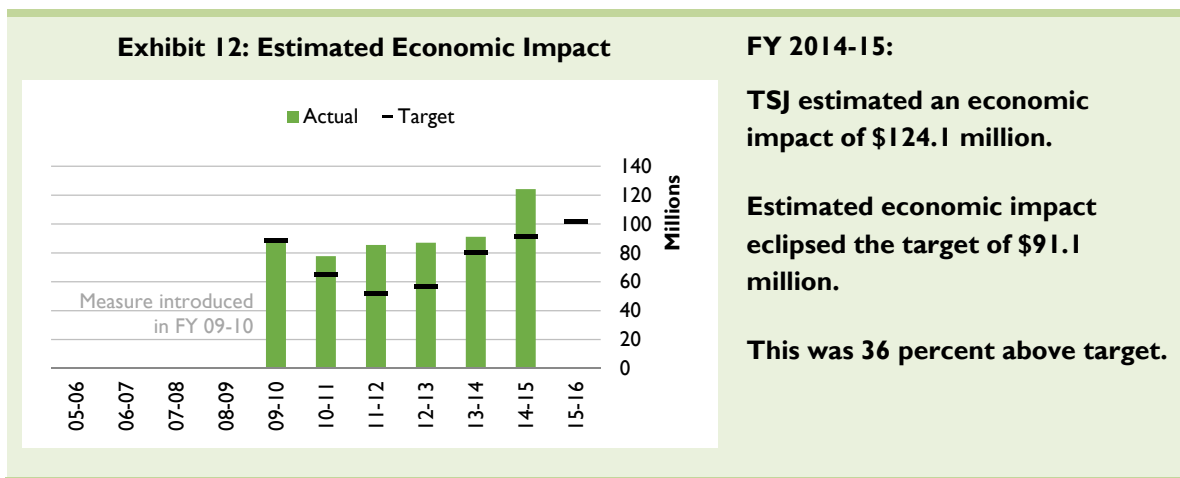
In setting the target, Team San Jose and the City had anticipated attendance to fall by 18.5 percent compared to the prior year, FY 2013-14, because improved corporate business would impact mid-week bookings by associations.

¹² For many events, Team San Jose verbally discusses attendance counts with the event organizer.

Even as the City lowered the target for FY 2014-15 compared to the prior year, Team San Jose was able to outdo its previous year’s performance by 10 percent and exceeded the target by 35 percent.

Team San Jose Eclipsed Its Target for Estimated Economic Impact

Estimated economic impact is an average daily spending rate multiplied by event attendance and duration. Average daily spending rates vary depending on event type (i.e., conventions and meetings, spectator sports and demonstrations, and participant sports and competitions) and attendee type (i.e., local/social visitors, out-of-town visitors, and exhibitors). For example, it is assumed that a local sports participant will spend \$18 or that an out-of-town visitor at a convention will spend \$242 in the City’s economy. Exhibit 12 shows the results for estimated economic impact.



Source: Auditor analysis of the Management Agreement, and TSJ event attendance reports, TSJ’s estimated economic impact calculations, and our prior TSJ audits.

The three largest events generating estimated economic impact were: FanimeCon 2015 (\$21.4 million), WrestleMania Axxess (\$10.2 million), and the 2015 Silicon Valley International Auto Show (\$9.6 million), see Exhibit 13. These three events contributed 33 percent towards TSJ’s estimated economic impact.

TSJ has met its estimated economic impact targets each of the six years it has reported on the measure. This measure is driven entirely by event attendance and the assumed spending rates.

TSJ eclipsed its target by a wide margin because the target had assumed lower attendance (see above).

Exhibit 13: Silicon Valley International Auto Show 2015

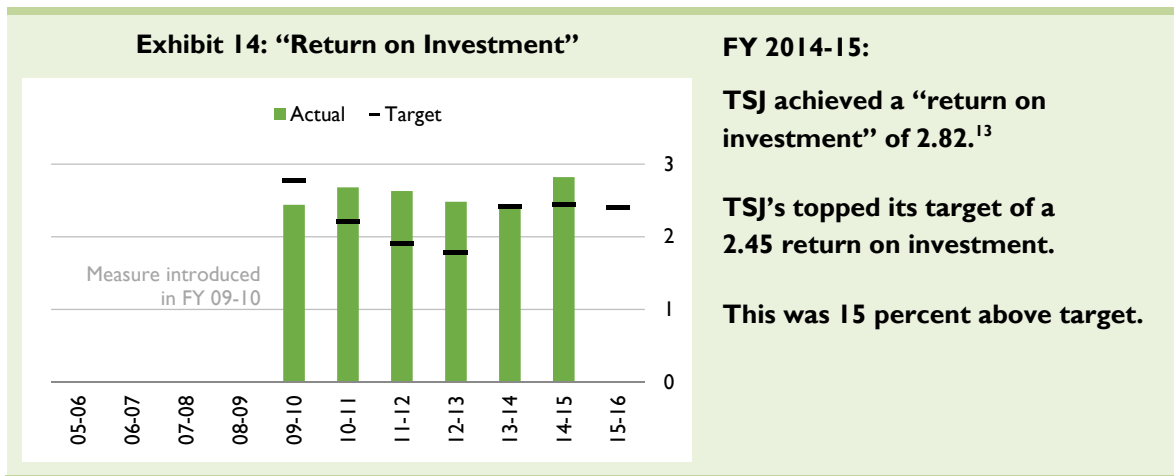


Photo by City Auditor's Office

Team San Jose Topped Its Target for "Return on Investment"

The Management Agreement's broad definition of "return on investment" is the sum of gross revenues from the operation of the Facilities, estimated economic impact, parking garage revenues, and the hotel tax allocation to the Convention and Cultural Affairs Fund; divided by the sum of expenses paid for the operation of the Facilities, Facilities debt service, parking garage expenses, and **some** other expenses paid by the Convention and Cultural Affairs Fund.

The intent is to measure the amount of financial benefit generated from the operation of the Facilities and the convention and visitors bureau as compared to the cost of generating such benefits. Exhibit 14 shows TSJ's results.



Source: Auditor analysis of the Management Agreement, audited financial statements for the Convention and Cultural Affairs Fund, the Convention Center debt service schedule, TSJ's estimated economic impact and return on investment calculations, parking garage revenue and expense reports, and our prior TSJ audits.

Note: Components included and excluded from the calculation changed in FY 2013-14 and again in FY 2014-15.

¹³ In its year-end report, before our performance audit, Team San Jose reported a 2.80 "return on investment." We are recognizing an additional \$400,000 in hotel tax revenue that Team San Jose had not counted in its calculation and used final building repair figures.

TSJ achieved its “return on investment” goal every year except FY 2009-10. Since FY 2010-11, TSJ has outperformed its goals for return on investment, because it is a formula-driven measure that increases when its inputs, especially estimated economic impact and gross revenue, increase.

This year, TSJ topped its target mainly because estimated economic impact had been underestimated when the City set the target. Exhibit 15 shows how “return on investment” was calculated for FY 2014-15.

Exhibit 15: Components of “Return on Investment”

<table> <tr> <td style="padding: 2px 5px;">\$124.1 million</td> <td style="padding: 2px 5px;"><i>Est. economic impact</i></td> </tr> <tr> <td style="padding: 2px 5px;">\$37.3 million</td> <td style="padding: 2px 5px;"><i>TSJ operating revenue</i></td> </tr> <tr> <td style="padding: 2px 5px;">\$9.7 million</td> <td style="padding: 2px 5px;"><i>Hotel tax revenue</i></td> </tr> <tr> <td style="padding: 2px 5px;">\$3.5 million</td> <td style="padding: 2px 5px;"><i>Parking garage revenue</i></td> </tr> </table>	\$124.1 million	<i>Est. economic impact</i>	\$37.3 million	<i>TSJ operating revenue</i>	\$9.7 million	<i>Hotel tax revenue</i>	\$3.5 million	<i>Parking garage revenue</i>	÷	<table> <tr> <td style="padding: 2px 5px;">\$15.3 million</td> <td style="padding: 2px 5px;"><i>Debt service¹⁴</i></td> </tr> <tr> <td style="padding: 2px 5px;">\$40.2 million</td> <td style="padding: 2px 5px;"><i>TSJ operating expenses</i></td> </tr> <tr> <td style="padding: 2px 5px;">\$2.8 million</td> <td style="padding: 2px 5px;"><i>Building repairs</i></td> </tr> <tr> <td style="padding: 2px 5px;">\$1.8 million</td> <td style="padding: 2px 5px;"><i>Commercial paper</i></td> </tr> <tr> <td style="padding: 2px 5px;">\$0.8 million</td> <td style="padding: 2px 5px;"><i>City overhead</i></td> </tr> <tr> <td style="padding: 2px 5px;">\$1.1 million</td> <td style="padding: 2px 5px;"><i>Parking garage expenses</i></td> </tr> </table>	\$15.3 million	<i>Debt service¹⁴</i>	\$40.2 million	<i>TSJ operating expenses</i>	\$2.8 million	<i>Building repairs</i>	\$1.8 million	<i>Commercial paper</i>	\$0.8 million	<i>City overhead</i>	\$1.1 million	<i>Parking garage expenses</i>	=	2.82
\$124.1 million	<i>Est. economic impact</i>																							
\$37.3 million	<i>TSJ operating revenue</i>																							
\$9.7 million	<i>Hotel tax revenue</i>																							
\$3.5 million	<i>Parking garage revenue</i>																							
\$15.3 million	<i>Debt service¹⁴</i>																							
\$40.2 million	<i>TSJ operating expenses</i>																							
\$2.8 million	<i>Building repairs</i>																							
\$1.8 million	<i>Commercial paper</i>																							
\$0.8 million	<i>City overhead</i>																							
\$1.1 million	<i>Parking garage expenses</i>																							

Source: Auditor analysis of the Management Agreement, audited financial statements for the Convention and Cultural Affairs Fund, the Convention Center debt service schedule, TSJ’s estimated economic impact and return on investment calculations, parking garage revenue and expense reports, and our prior TSJ audits.

For hotel tax, see Exhibit 9, footnote (B). Fund 536 is the Convention and Cultural Affairs Fund.

The City had set the target at the same level as the previous year, FY 2013-14. The City anticipated that “return on investment” would not grow because of planned capital spending during FY 2014-15.

The “Return on Investment” Formula Is Not Traditional

It is important to note that this does **not** mean that the Convention and Cultural Affairs Fund received \$2.82 in net profit for every \$1 invested, as would be suggested by the traditional calculation of return on investment (i.e., the traditional definition of return on investment is net profit divided by investment).

Instead, the Management Agreement’s broad definition of “return on investment” is largely driven by estimated economic impact; that is to say, it measures spending in San José’s economy as a result of conventions and other events (i.e., at restaurants, at the Airport, for transportation, and in hotels and retail establishments).

The “Return on Investment” Formula Excludes Certain Expenses

Certain expenses paid by the Convention and Cultural Affairs Fund did **not** factor into the calculation of “return on investment,” as agreed between the City and Team San Jose. For example:

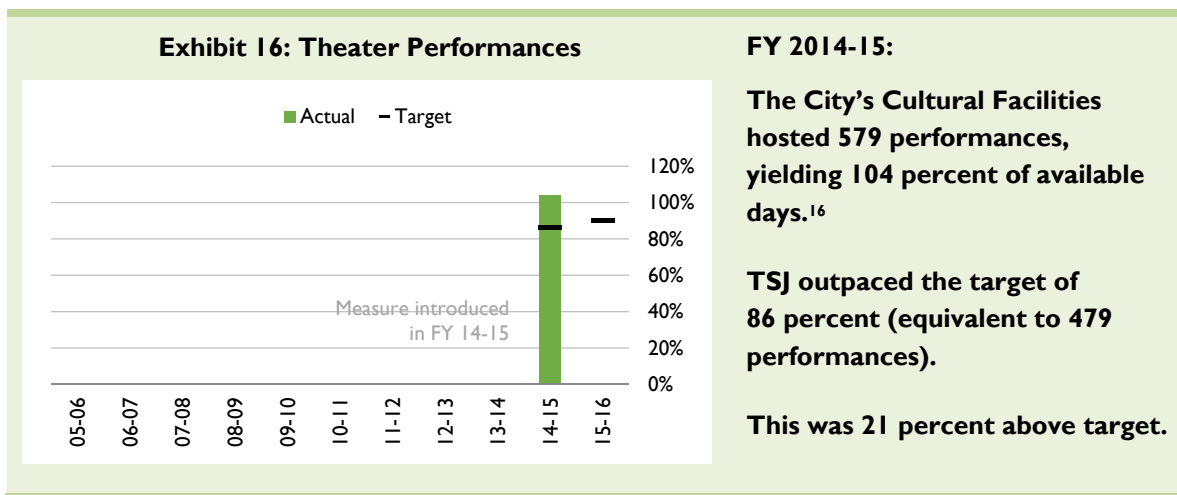
¹⁴ \$15.3 million is the amount of the annual debt service for the original construction of the Convention Center. This calculation does not show the \$8.2 million annual payment for debt service for the 2011-2013 renovation and expansion.

Team San Jose's Performance 2014-15

- Debt service of \$8.2 million for the Convention Center expansion, paid for by a 4 percentage point increase in special hotel taxes (approved in June 2009) – would have lowered “return on investment” by 0.33
- The management fee of \$1,000,000 paid by the City to Team San Jose – would have lowered “return on investment” by 0.04

Team San Jose Outpaced Its Target for Theater Performances

Theater performance, as shown in Exhibit 16, is measured as the number of *performances*, divided by available days at the four Cultural Facilities: the City National Civic, the Center for the Performing Arts, the California Theatre, and the Montgomery Theater. Performances include dances, theater shows, sports events, musical and comedy shows, speakers, and cultural performances generally available for the public. For FY 2014-15, the City set the number of available days at 559.¹⁵



Source: Auditor analysis of the Management Agreement, TSJ's theater records, and our prior TSJ audits.

TSJ reported that 445 performance *days* were contributed by the City's resident art partners – Symphony Silicon Valley, the Children's Musical Theater of San Jose, Opera San Jose, and Ballet San Jose.

This performance measure was newly established for FY 2014-15. Previously, the performance measures had been the number of occupied *days* and performance *days*.

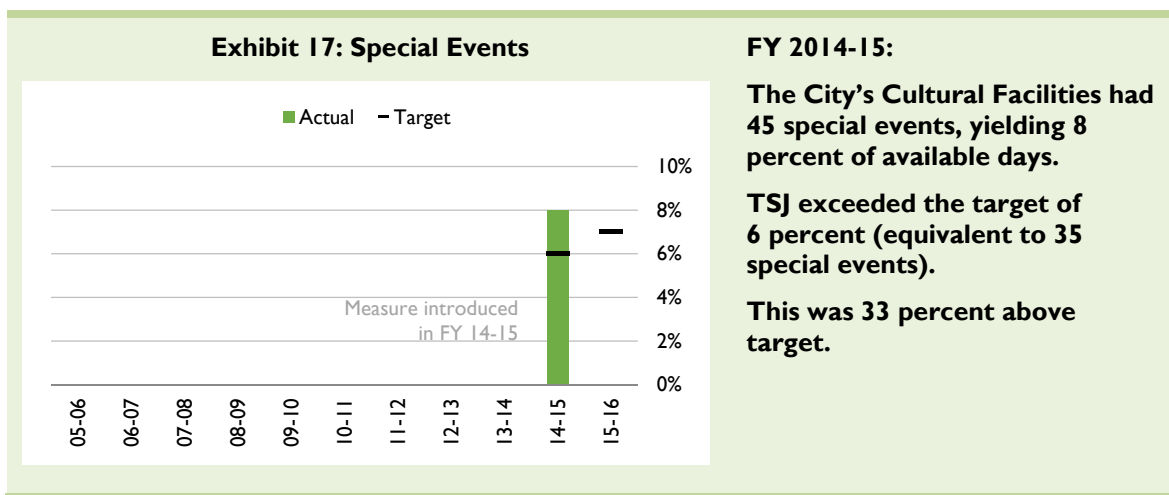
¹⁵ The Management Agreement defines available days as: calendar days that are both available and suitable for booking Performances and Special Events. The City's target-setting memorandum further explained that available days exclude: move-in and move-out days, typically unsellable weekdays, unsellable holiday periods, and dates held by resident art partners.

¹⁶ Multiple performances on a single day can result in performance above 100 percent.

Team San Jose does not have standard operating procedures or a detailed written methodology for calculating available days, performances, and special events. Instead, it relied on the definitions in the Management Agreement. In our opinion, Team San Jose should have a standard operating procedure that assigns staff responsibilities and provides guidance to staff on how to count those metrics, in more detail than the Management Agreement.¹⁷

Team San Jose Met Its Target for Special Events

Special Events, as shown in Exhibit 17, are not open to the public, in contrast to theater performances described above. They are also measured as percentage of available days.



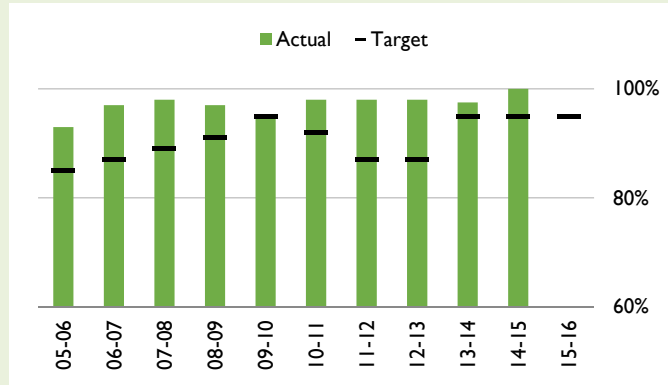
Source: Auditor analysis of the Management Agreement and its amendments, TSJ's theater records, and our prior TSJ audits.

Team San Jose Met Its Target for Customer Satisfaction

Customer satisfaction, as shown in Exhibit 18, is the percentage of event coordinators who responded to a customer survey with an overall satisfactory rating of the product and services provided. Responses of "excellent," "very good," or "good" are considered satisfactory.

¹⁷ Even though the City and Team San Jose agreed to express the theater measures as percentage of available days, in our opinion, the City and Team San Jose should consider revising the presentation of this performance measure. Instead of calculating performances and special events as percentages of available use days, it would be more transparent to simply count the number of performances and special events, and list them as well as list available days. This would also avoid intermediate rounding in the percentage calculations.

Exhibit 18: Customer Satisfaction



FY 2014-15:

100 percent of TSJ customers were satisfied.¹⁸

TSJ exceeded the target of 95 percent satisfaction.

This was 5 percent above target.

Source: Auditor analysis of the Management Agreement and its amendments, TSJ's customer service survey results, prior TSJ audits.

The response rate was about 48 percent. For customer satisfaction, Team San Jose has met its targets for all past ten years. According to TSJ and the City, the industry standard is 90 percent. In setting this year's target, the City had assumed customer satisfaction would decline.¹⁹

Team San Jose Achieved a Performance Score of 125 and an Incentive Fee Score of 131 Percent in FY 2014-15

As shown above, Team San Jose met its targets for all eight performance measures. In accordance with the Management Agreement, this resulted in a total weighted performance score of 125 percent. Team San Jose also met its targets for all seven incentive fee measures, resulting in a total weighted incentive fee score of 131 percent (see Exhibit 2 above).

The City paid Team San Jose \$1,000,000 in management fees in FY 2014-15.²⁰ In addition to this, the City will make an incentive payment of \$200,000 if Team San Jose's incentive fee score is 100 percent or greater. We found that Team San Jose qualifies for this incentive fee.

The 2014-2019 Management Agreement revised the management and incentive fee amounts and removed the thresholds above 100 percent which qualified Team San Jose for increasing incentive fees. This means that Team San Jose receives the

¹⁸ The 100 customer service survey responses included 75 excellent, 21 very good, and 4 good scores.

¹⁹ The Management Agreement requires that the City be sent a copy of each survey response.

²⁰ According to the Management Agreement, the Fixed Management Fee is intended to provide, without limitation, for payment of a portion of the expenses incurred by TSJ for the management of the operations and maintenance of the City's Facilities, as determined by the TSJ Board of Directors. It is our understanding that it covers executive salaries and benefits, among other things.

\$200,000 incentive fee on a pass/fail basis and it is no longer tied to *how much* performance exceeded 100 percent.²¹

The City Needs to Ensure It Receives Reports from Team San Jose

The Management Agreement requires Team San Jose to provide quarterly reports to the City; these are to include financial analyses and breakdowns for each facility, and other operational issues.

During 2014-15, the City Council's Committee for Community and Economic Development only heard the first quarter's report in October 2014 and it did not contain detailed finances or breakdowns by facility. City staff intends to bring the remaining three reports to the Council committee in November 2015.

In 2012, the City Auditor's Office recommended that Team San Jose show its Convention and Visitors Bureau (CVB) accomplishments together with its targets to make the reports more meaningful to readers. In 2014, Team San Jose stopped reporting CVB performance and targets, as the City and Team San Jose were working with an adviser to determine more focused metrics.

Currently, the CVB metrics are hotel room nights and estimated economic impact, which are the same performance measures as for the Convention and Cultural Facilities, discussed previously in this report. Team San Jose is required to report its CVB performance quarterly to the City.

In its most recent 2014-15 year-end report to the City, Team San Jose also described its media communications, travel professionals it hosted, and the number of social media followers. The City will be reviewing these measures to assess whether they are meaningful indicators for monitoring CVB's performance.

Roles for Managing the Theater Preservation Fee Need Clarification

In 2007, the City Council approved a **framework** for collecting and spending a \$1 per-ticket theater preservation fee charged to theater patrons.²² This new revenue stream was intended to pay for facility improvements at the Cultural Facilities, as City funds alone were projected to not be enough for long-term capital needs.

²¹ Under the 2009-2014 Management Agreement, as amended, Team San Jose received a fixed minimum management fee of \$150,000 and a fixed executive management fee of \$600,000. In addition, the City paid an incentive fee ranging from \$200,000 to \$350,000 depending on performance thresholds above 100 percent. Thus the total compensation could have been \$1.1 million.

²² The resolution adopted by the Council authorized City staff to negotiate and execute a contract amendment with Team San Jose to implement the theater preservation fee. During our audit we could not locate any contract that governs the City's relationship with these organizations and the City's role regarding the fee. The City's current Management Agreement with Team San Jose does not address the theater preservation fee.

The Council envisioned that the fee would be collected, managed, and spent by a new non-profit organization governed by a board of directors representing the City's arts partners, Team San Jose, and the City (including one City representative and one Redevelopment Agency representative). The board would decide how to use the funds and ensure they went towards theater preservation.

Theater Patrons Have Paid a \$1 Fee per Theater Ticket Since 2007

In accordance with the City Council's intent, Team San Jose and the arts partners created a new non-profit, *San Jose Theater Preservation, Inc.*, and began collecting the \$1 fee. For example, one project financed by this fee was a replacement of chairs in the Civic Auditorium.

From 2007 to 2010, Team San Jose collected all fees, managed the financial transactions, prepared financial statements, and obtained an annual financial audit. Since 2010, *San Jose Theater Preservation* managed its own bank account and while Team San Jose collected some fees, some other fees were sent directly to San Jose Theater Preservation.

Team San Jose stopped forwarding theater preservation fees to *San Jose Theater Preservation* in 2015, and at the time of our audit was holding a balance of \$200,000. *San Jose Theater Preservation* also was holding a substantial account balance, apparently.

The City's and Team San Jose's Roles Need Clarification

As facility improvements would affect City-owned buildings and Team San Jose's management of these buildings, the City should be formally involved in planning and prioritizing future projects as well as managing current projects. The City originally intended to participate in managing the fee by sending two representatives to the board of directors of *San Jose Theater Preservation*. Even though the fee was intended to pay for facility improvements at City-owned theater buildings, the City has been minimally involved in recent years and its current role is not well-defined.

Recommendation #1: The City Manager's Office, Team San Jose, and San Jose Theater Preservation Inc., should evaluate and clarify their respective roles in collecting, managing, and expending theater preservation fees.

Conclusion

In FY 2014-15, Team San Jose met all targets on its nine measures. It surpassed its financial targets. It met all economic impact targets. It achieved its customer service goal and two theater performance goals. Altogether, Team San Jose achieved a weighted incentive fee score of 131 and thus qualifies to receive the incentive fee of \$200,000 from the City.

The City's role and Team San Jose's role in managing the theater preservation fee needs to be clarified.

RECOMMENDATIONS

Recommendation #1: The City Manager's Office, Team San Jose, and San Jose Theater Preservation Inc., should evaluate and clarify their respective roles in collecting, managing, and expending theater preservation fees.

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Appendix A

Methodology for Calculating Performance and Incentive Fee Measures

Measures	Type of Measure	Methodology for Calculation
Gross Revenue and Gross Operating Profit		
Gross Revenue	Incentive only	Those revenues from operation of the Facilities excluding revenue billed by TSJ on behalf of other vendors providing services to clients of the Facilities.
Gross Operating Profit	Performance only	<p>The 2014-2019 Management Agreement defines “gross operating profit” with a set formula:</p> <p>Gross revenue from operating the Facilities + hotel tax revenue allocated to the Convention and Cultural Affairs Fund + Revenue from the parking garage at the Convention Center</p> <p>Minus</p> <p>Direct and indirect expenses for operating the Facilities (excluding City-directed expenses, City oversight, fire insurance, repairs and maintenance, depreciation, and the management fee paid by the City to Team San Jose) + Expenses for the parking garage at the Convention Center</p> <p>The third amendment to the 2009-2014 Management Agreement, effective September 2012, majorly changed the methodology for the gross operating profit calculation by adding hotel taxes and the parking garage to the formula.</p>
Economic Impact		
Hotel Room Nights	Performance and Incentive	Measured as the total number of future hotel room nights booked by the CVB over the course of the Fiscal Year and the total number of future hotel room nights booked that can be directly or indirectly attributed to activities at the Facilities.
Event Attendance	Performance and Incentive	Number of local/social visitors, out-of-town visitors, and exhibitors who attend events at the Convention and Cultural Facilities.
Estimated Economic Impact	Performance and Incentive	Average daily spending rates multiplied by event attendance and duration. Average daily spending rates vary depending on event type (i.e., conventions and meetings, spectator sports and demonstrations, and participant sports and competitions) and attendee type (i.e., local/social visitors, out-of-town visitors, and exhibitors). This methodology was mutually agreed upon by the City and TSJ as a means to estimate consumer spending related to events.
Return on Investment	Performance only	<p>The Management Agreement defines “return on investment” with a set formula:</p> <p>[gross revenues from the operation of the Facilities] + [estimated economic impact] + [hotel tax revenues allocated to the Convention and Cultural Affairs Fund] + [Convention Center parking garage revenues]</p> <p>divided by</p> <p>[operating expenses of the Facilities] + [some expenses of the Convention and Cultural Affairs Fund, including CVB funding] + [some Facilities debt service] + [Convention Center parking garage expenses]</p>

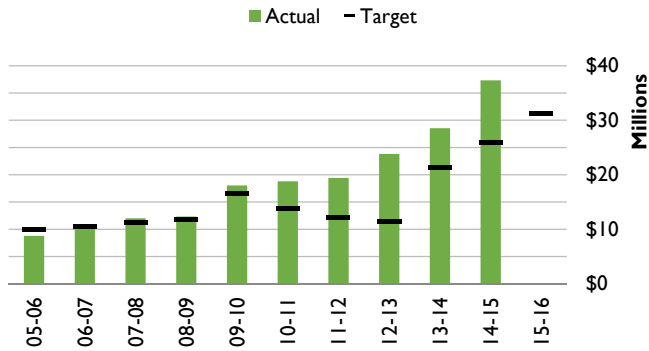
Measures	Type of Measure	Methodology for Calculation
Theater Performance		
Performances	Performance and Incentive	Number of performances divided by available days at the four Cultural Facilities. Performances include dances, theater shows, sports events, musical and comedy shows, speakers, and cultural performances generally available to the public. Available days exclude: move-in and move-out days, typically unsellable weekdays, unsellable holiday periods, and dates held by the City's resident art partners.
Special Events	Performance and Incentive	Number of special events divided by available days. Special events are not open to the public.
Customer Satisfaction		
Satisfaction Rate	Performance and Incentive	The results of the TSJ's surveys that ask the event coordinators to rate their overall satisfaction with the product and services provided. Responses of "excellent," "very good," or "good" are considered satisfactory.

Source: Auditor summary of terms outlined in the Management Agreement and other issues identified during course of audit work

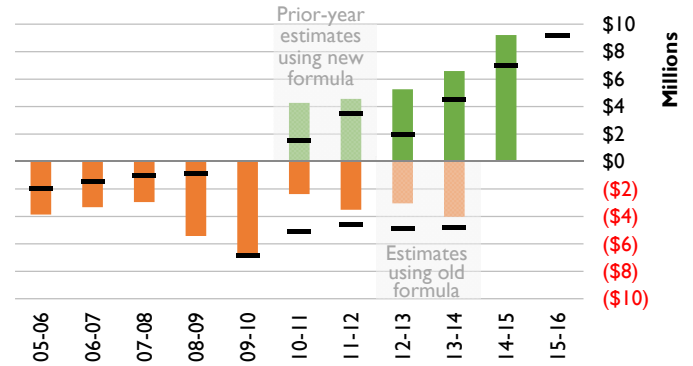
APPENDIX B

Team San Jose Targets and Performance Since FY 2005-06

Gross Revenue

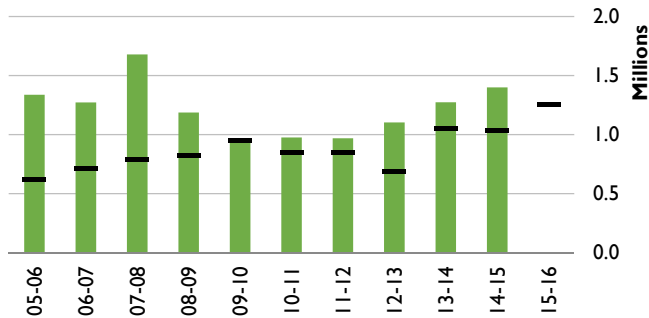


"Gross Operating Profit"

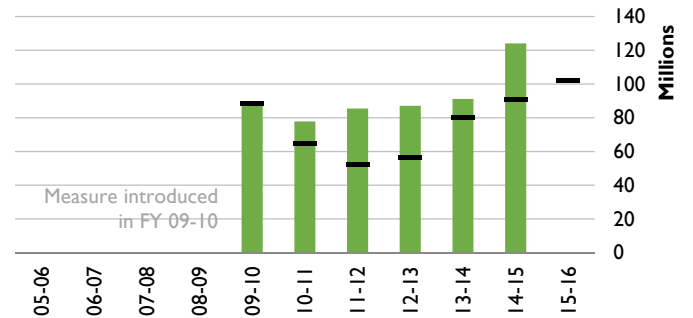


The gross operating profit calculation was modified effective FY 2012-13: the red bars show the old formula, the green bars the new formula.

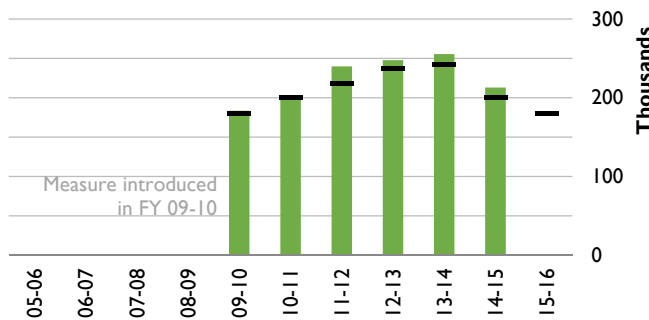
Event Attendance



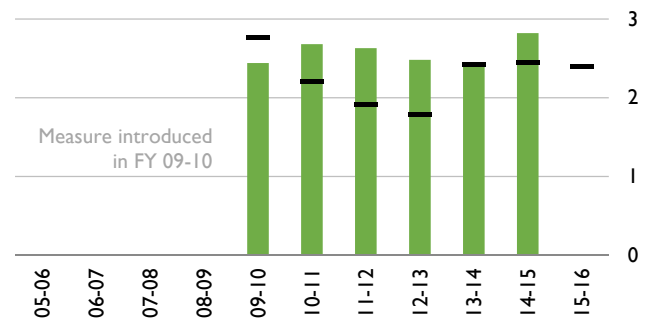
Estimated Economic Impact



Hotel Room Nights



"Return on Investment"



The return on investment components changed in FY 2013-14 and 2014-15.

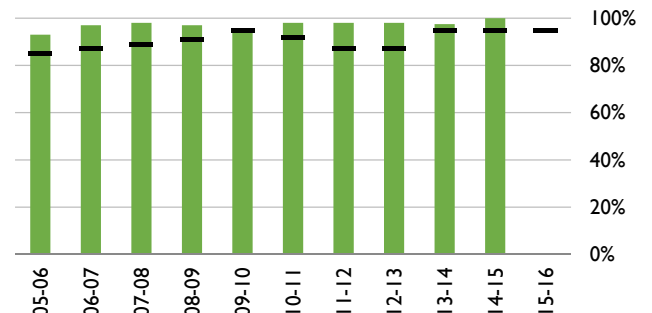
Theater

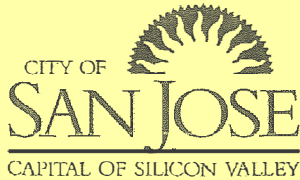
Performances:
Target: 86%
Actual: 104%

Special Events:
Target: 6%
Actual: 8%

(New performance measure for FY 2014-15; previously the measures were occupied days and performance days)

Customer Satisfaction





Memorandum

TO: SHARON ERICKSON
CITY AUDITOR

FROM: KIM WALESK
DEPUTY CITY MANAGER

SUBJECT: RESPONSE TO THE AUDIT OF
TEAM SAN JOSE'S
PERFORMANCE 2014-15

DATE: November 3, 2015

Approved

Date

11/5/15

As part of the City's Management Agreement with Team San Jose (TSJ) to operate the San José McEnery Convention Center and six cultural facilities, the City Auditor is tasked to review Team San José's results for the performance measures called out in the agreement each fiscal year. The Department greatly appreciates the important work of the City Auditor and her staff for this evaluation and looks forward to improving both the current performance and future programs. The following is the Administration's response to the one recommendation identified in the 2014-15 audit.

BACKGROUND

In June 2014, the City and TSJ entered into a new Management Agreement for the period of July 1, 2014 through June 30, 2019 with two additional five-year options. This Agreement sets new performance measures for the operation of the San José McEnery Convention Center, Parkside Hall, South Hall, the City National Civic, the Center for the Performing Arts, the California Theatre, and the Montgomery Theater. Under the agreement, TSJ can qualify for an incentive fee if it meets or exceeds its performance measures each year. For 2014-15, TSJ has qualified for the full \$200,000 incentive fee.

In addition to reviewing the performance measures, the City Auditor provides insight on elements of process, data reporting or other management practices that could potentially be improved or modified. In the course of this regular review, the Auditor has identified one area of operation that warrants a recommendation.

RECOMMENDATIONS AND ADMINISTRATION'S RESPONSE

Recommendation #1: The City Manager's Office, Team San Jose, and San Jose Theater Preservation Inc., should evaluate and clarify their respective roles in collecting, managing, and expending theater preservation fees.

Administration's Response to Recommendation #1:

Response Narrative: The Administration agrees with this recommendation.

The establishment of the Theater Preservation Fee framework by Council and all of the partners in 2007 was a well-intended initiative to fund the quality-of-experience items that make cultural facilities more useful, but often fall low in the prioritization of capital needs. Unfortunately, the dissolution of the Redevelopment Agency and key staff turnover left gaps in developing clear understanding of the intent, administration and oversight of these monies. For example, questions exist about whether these monies are truly a required City fee or rather a voluntary donation by the City's cultural partners.

As important as the original intent, is building agreement around the oversight and administration needed for the ongoing success of this initiative. Staff will work with both San Jose Theater Preservation Inc. and Team San Jose to clarify the goals of the fee, current practices, and any needed modifications to ensure compliance both with the Council's initial direction as well as reaffirming a structure that is in line with both IRS and City fiduciary responsibilities.

Target Date for Completion: June 2016

Policy work section:

Depending on the outcome of this process, there may be a need for Council action to clarify the City's role in the administration of these monies.

Green Light

Yellow Light

Red Light

Refer to budget process

Refer to Council Priority Setting

SHARON ERICKSON, CITY AUDITOR

November 3, 2015

Subject: Response to Audit of Team San José's Performance 2014-15

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COORDINATION

This memo was coordinated with the City Manager's Budget Office and City Attorney.

CONCLUSION

Staff concurs that this is an item that warrants examination and clarification to ensure the efficient operations of City-owned facilities and critical cultural partners. Staff thanks the City Auditor and Auditor's staff for their work on the Audit.

/s/

KIM WALESH

Deputy City Manager

Director, Office of Economic Development

For questions, please contact Teri Killgore, Downtown Manager at (408) 535-8102.